

Price Planning

Chapter 25





Sec. 25.2 – Factors Involved in Price Planning

What you'll learn

- The four market factors that affect price planning
- What demand elasticity is in relation to supply and demand theory
- The government regulations that affect price planning



Market Factors Affecting Prices

- **Costs and Expenses** -- Declining profits may be caused by an increase in costs or expenses
- Response may be to
 - make the size of a product smaller
 - drop features
 - improve their products.

Example – Airlines quit serving meals



Break-Even Point

- The point at which sales revenue equals the costs and expenses of making and distributing a product.
- After this point is reached, businesses begin to make a profit on the product.



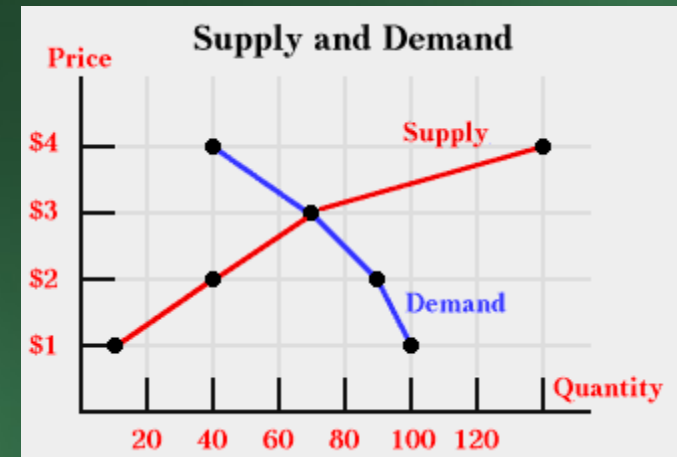
Break-Even Point

- A toy company makes 100,000 dolls to be sold at \$6 each.
- What is the break-even point?
- The cost of manufacturing and marketing the dolls is \$4.50 each, or \$450,000 for the 100,000 dolls.
- $\$450,000 / 6 = 75,000$
- To break even, the firm must sell 75,000 dolls; after that the firm will begin to make a profit.

Market Factors Affecting Prices

- Supply and Demand


- Elastic demand – a change in price creates a change in demand
- Inelastic demand – a change in price has little effect on demand





ELASTIC DEMAND – A change in price corresponds to a change in demand

<u>DVR Price</u>	<u>Number Purchased</u>	<u>Total Sales</u>
\$300	500	\$150,000
\$400	300	\$120,000
\$500	100	\$50,000



INELASTIC DEMAND -- The demand is constant, even if the product's price changes.

<u>Milk Price (Gallon)</u>	<u>Number Purchased</u>	<u>Total Sales</u>
\$2.00	1,000	\$2,000
\$2.50	985	\$2,462
\$3.00	975	\$2,925

Demand Elasticity Varies

- **Brand Loyalty** --
Some customers won't accept a substitute product –
“I will only buy a SONY”
- Demand becomes inelastic.



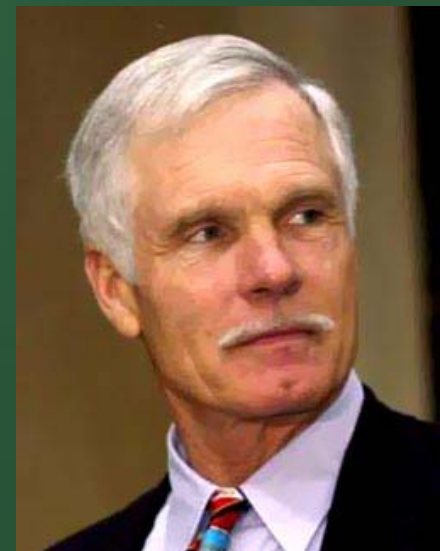
Demand Elasticity Varies

- Availability of substitutes
- If a substitute is readily available, demand becomes more elastic.



Demand Elasticity Varies

- Price relative to income
- If an increase in price is significant relative to one's income, demand is likely to be elastic.
- A wealthy person may not care about the increasing price of gas.



Demand Elasticity Varies

- Luxury vs. necessity
- If a product is a necessity, demand tends to be inelastic.
- If a product is a luxury, demand tends to be elastic.



Demand Elasticity Varies

- Urgency of purchase
- If the purchase must be made immediately, demand tends to be inelastic.
- If you're running out of gas you will stop at a station that charges more.





Market Factors Affecting Prices

- Competition

- Price must be evaluated in relation to the target market
- Competitors must watch each other closely
- When one company changes its prices, others usually react.

Market Factors Affecting Prices

- Consumer Perceptions



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Legal and Ethical considerations for Pricing

- Federal and state governments have enacted laws controlling prices.





Government Regulations Affecting Price

- **Price Fixing** – when competitors agree on certain price ranges within which they set their own prices. Collusion is evident. It's illegal.
- **Price Discrimination** – when a firm charges different prices to similar customers in similar situations – creates unfair competition.



- **Resale Price Maintenance** – A manufacturer may suggest resale prices but can't punish retailers that sell at a lower price.
- **Minimum Price Laws** – Prevent retailers from selling below cost



- **Unit Pricing** – allows consumers to compare prices in relation to a standard unit or measure.
- **Price Advertising** – FTC has guidelines – can't say your prices are lower without proof
 - Bait and Switch – advertising a low price for something the business doesn't intend to sell -- Illegal